

ICPS newsletter

Appearances can be deceptive Debate on the independent regulator in the Ukrainian telecoms sector

A heated discussion about establishing a telecoms regulator has unfolded in Ukraine. The discussion participants consider it necessary to ensure the “independence” of such an institute, following Western organisational models. However, the implications of wholesale copying of Western models onto the present Ukrainian reality can be inadequate, due to the gross effect from a number of factors. If we put aside institutional factors, then we can actually expect negative rather than positive consequences. This issue was evaluated in an article by ICPS consultant Alex Sundakov, published in the Kyiv Post

Recent heated political debates about the “independence” of the proposed National Commission for Telecommunications provide an excellent example of how easy it is to be misled by appearances. The issues around the creation of a regulatory agency for the Ukrainian telecommunications market were reduced to a battle of labels; “independence” for such a body along Western organisational lines was labelled “pro-reform”, while the alternatives were “anti-reform”. The rhetoric suggested that only the “forces of darkness” could be against replicating a Western model in order to create a telecommunications market environment similar to that in developed countries.

The reality, as always, is more complicated. The lesson is that any institutional reform must take into account the specifics of each country, its political and organisational culture, the legal environment, and the rules of accountability. When we consider these, a Western-style independent regulator is, in fact, more likely to be “anti-reform” in the Ukrainian context. The main reason is that in developed countries, regulatory “independence” means never to make decisions without external controls or a high degree of accountability. In fact, in most countries, considerable attention is paid to ensuring that “independent” regulatory agencies have relatively few degrees of freedom, that they operate within tightly defined criteria, and that they are subject to external oversight. Yet such constraints are lacking within the Ukrainian institutional context.

The importance of these constraints becomes clear when we consider the main reason for regulatory “independence”. Regulatory decisions frequently involve trade-offs between competing commercial interests—for example, of different telecommunications operators. It is important to ensure that a regulator is not captured by one or another of these interests. Commercial capture of regulatory decision making can occur in a number of ways. One obvious problem is political interference; if one of the operators has better access to political leaders, it may be able to influence decisions in its favour. This is why it may be desirable to find some way to insulate the regulator from day-to-day control by politicians.

However, commercial capture of the regulators through the political process is only one of the risks. Any regulatory body can be captured through bribes, or through influence in appointing members of this “independent” body. In fact, under some circumstances, too much independence from political oversight may be a problem in itself, if political leaders are more accountable (for example, through public scrutiny) than the appointed members, and hence are less prone to capture.

The risk of regulatory capture through political influence inside the government needs to be set against the risk of direct capture of an “independent” regulatory agency by commercial interests. In Ukraine’s case, the risk that commercial interests will exercise influence to appoint people to an independent agency, and that

such people would then act without any accountability, must be rated as very high. Hence, in Ukraine, perhaps more so than in other countries, it is critically important not to create an unguided missile out of an “independent” agency.

What are the requirements for ensuring that an independent regulatory agency is a viable option? As I emphasised above, “independence” does not mean that such regulators are free to do whatever they want. In reality, independent regulators in most countries operate under very tight constraints; they are given detailed and precise criteria for making decisions, they follow prescribed processes, and they are tightly held to account, including rights of appeal. The only independence they exercise is in judging how the circumstances of each particular case compare against the pre-determined standards.

The criteria for regulatory decisions must be transparent, well understood, and set out in legislation. The regulator must be provided with clear instructions that specify the objectives of regulation, the methodology to be followed, the criteria for evaluating information that may be supplied to the regulator, and the standards of information and analysis necessary for making decisions. For example, with regard to price regulation, laws dealing with the telecommunications sector in most countries specify that prices for regulated services are to be set equal to the long-run incremental costs of providing these services. The long-run incremental cost concept is very specific, and there is a well-established and reasonably objective methodology for calculating such costs. In other words, an independent regulator is given very precise guidance.

The area of competence of an “independent” regulator must also be very specific, and narrowly defined. For example, in most countries, telecommunications regulators are given a narrow list of services whose prices they can regulate, and a law change is required to change that list.

This is necessary to manage the risk of empire building by regulators.

Moreover, the decision-making process must be carefully designed to ensure fairness and to prevent regulatory capture. For example, most countries specify detailed procedures for price regulation. The details differ from country to country, but the basic outline is broadly similar. The regulator first issues guidelines outlining its approach and information requirements. All market participants are given an opportunity to comment. The regulator then calls for submissions on the specific level of prices that should be set. All market participants are again allowed to present submissions. The regulator then issues a draft decision. Finally, all market participants are allowed

to respond before the full determination is made. While this may seem slow and cumbersome, a process of this kind is necessary to ensure the quality of the decision.

Perhaps most importantly, while an independent regulatory agency should be insulated from day-to-day political pressures, it must have a clear accountability regime. The most common accountability tool used in such cases is the right of appeal to court. Any market participant can ask the court to consider whether the regulator complied with its criteria, whether it followed a fair process and took all relevant information into account, and whether it made any mistakes in assessing the specifics of the case.

None of the above preconditions for the “independence” of regulatory bodies is present in Ukraine. In their absence, an organisation that looks like its Western counterpart is likely to bring about quite different outcomes. Without the institutional context, the adoption of the appearances of the Western model will do more harm than good, and the risk of regulatory capture will rise. ■

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Forthcoming elections in Ukraine are expected to ameliorate economic policy

There can be no doubt that the parliamentary elections will alter national economic policy, which will crucially depend on the parties that will sit in parliament. Generally speaking, we expect the new convocation of the Verkhovna Rada of Ukraine to come up with a more effective economic policy. At a meeting of the European Business Association, ICPS expert Hlib Vyshlinsky presented a forecast of the implications from the Verkhovna Rada elections for Ukraine's economy

Polymaking entails a sequence of measures aimed at accomplishing public goals. According to this criterion, we can maintain that Ukrainian parties have never yet produced any consistent policy vision for consideration of the Ukrainian public. Moreover, there has been a lack of concrete measures designed to achieve the targeted goals in existing party programs. In particular, the public-at-large and business representatives are not allowed to control parties' activities or to influence them between elections.

Under these circumstances, declared party visions regarding economic policy can be overhauled once the party is installed in the parliament. Party programs do not furnish any exhaustive replies to questions about future party policy, either. So, we can only be guided by the reputation and the current activities of the party leaders. Such ambiguity breeds uncertainty as to future policy, and this makes it really complicated to forecast the impact of parliamentary elections on economic policy.

In any party's platform, the proposed economic policy can be judged by the following criteria: (1) ideologies respected by the party; and (2) interests lobbied by the party.

Determining the principal frameworks of economic policy largely depends what ideology the party pursues—communist or liberal. These ideologies can be weighed against the following set of criteria:

- role of the state in the economy;
- attitudes to private entrepreneurship;
- share of GDP re-allocated by the State Budget.

As far as interests lobbied by the party, are concerned, they can be assessed using a conventional scale, where one end is public interests and the other is private interests. The more a party's proposed policy covers “public” interests, the bigger share of societal groups benefits, and vice versa. In order to determine the extent of “social responsiveness” of interests, we can use the following set of criteria:

- party position towards how rigidly the law

should regulate the activities of government authorities;

- support or rejection of transparent procedures of adopting government decisions;
- attitude to barter transactions.

We expect that the future Verkhovna Rada will be less affected by Communist ideology than it used to be. Nevertheless, parties for whom the public interest is a priority will still have a majority representation in the Parliament of the new convocation.

We expect the future parliament of Ukraine to be more accountable. A particular feature of the current election campaign is that the mass media has given more airtime to evaluating and delivering to voters the election platforms of parties involved, first of all through televised debates. Under these circumstances, parties elected to the Verkhovna Rada of Ukraine will have to abide more diligently by their declared goals.

The above factors should enhance the quality of economic policy in Ukraine. Namely, we expect that such a positive change will spur Ukraine's economic growth to 5.5% in 2003 (for 2002, the forecasted GDP growth is 4.5%). ■

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